HM Treasury's approach to financial services legislation under the European Union (Withdrawal) Act

1.1 This paper sets out HM Treasury's approach to laying financial services statutory instruments (SIs) under the EU (Withdrawal) Act, which forms part of the wider work the government is undertaking to prepare for the UK's withdrawal from the EU. The government is confident that the implementation period, agreed between the UK and the EU earlier this year, will be in place between 29 March 2019 and 31 December 2020. Nevertheless, the government will ensure that a workable legal regime is in operation whatever the outcome of negotiations.

The implementation period

1.2 The UK and the EU have agreed the terms of an implementation period that will start on 29 March 2019 and last until 31 December 2020. This will provide time to introduce the new arrangements that will underpin our future relationship, and provide valuable certainty for businesses and individuals. During the implementation period, common rules will continue to apply. The UK will continue to implement new EU law that comes into effect and the UK will continue to be treated as part of the EU's single market in financial services. This will mean that access to each other's markets will continue on current terms and businesses, including financial services firms, will be able to trade on the same terms as now until 31 December 2020. UK firms will need to comply with any new EU legislation that becomes applicable during the implementation period.

1.3 During this period, EU financial services firms operating in the UK, and UK financial services firms operating in the EU, will be able to continue to undertake regulated activities, either by means of passporting rights or under other relevant EU frameworks. Similarly, UK financial market infrastructures that are authorised under the existing EU framework, such as central counterparties, will continue to be able to provide services to the EU. EU and third country (non-EU) financial market infrastructures that have existing authorisation or recognition under EU legislation will continue to be able to provide services to the UK, enabling access to financial market infrastructures without disruption.

1.4 Inbound firms that are currently permitted to operate in the UK without UK authorisation or recognition may plan on the assumption that UK authorisation or recognition will not be needed before the end of the implementation period, following guidance from the UK's financial services regulators[1].

1.5 In addition to agreeing the terms of the implementation period, good progress has been made across the Withdrawal Agreement, and discussions are ongoing on the terms of the UK's

[1] *Update on the Regulatory Approach to the Approach to preparations for EU withdrawal,* Bank of England, March 2018. https://www.bankofengland.co.uk/news/2018/march/update-on-the-regulatory-approach-to-preparations-for-eu-withdrawal

And *FCA statement on EU withdrawal following the March European Council,* Financial Conduct Authority, March 2018. https://www.fca.org.uk/news/statements/fca-statement-eu-withdrawal-following-march-european-council

future relationship with the EU. The UK and the EU will continue to progress negotiations on the Withdrawal Agreement and Future Framework.

1.6 The government is seeking a deep and special future partnership with the EU, which should be greater in scope and ambition than any such agreement before and encompass financial services. Given the highly regulated nature of financial services, the volume of trade between our markets, and our shared desire to manage financial stability risks, we would need a stable process for maintaining equivalent regulatory outcomes as legislation evolves – including a system to resolve disagreements at regulatory and supervisory levels – alongside an open, collaborative relationship between supervisors that protects our respective financial systems and our taxpayers from financial stability risks.

1.7 The government has confirmed its intention to bring forward a new bill - the Withdrawal Agreement and Implementation Bill - to give effect to the major elements of the Withdrawal Agreement with the EU in domestic law, including the implementation period.[2]

The European Union (Withdrawal) Act and financial services contingency preparations

1.8 While the government has every confidence that a deal will be reached and the implementation period will be in place, it has a duty to plan for all eventualities, including a 'no deal' scenario. The government is clear that this scenario is in neither the UK's nor the EU's interest, and we do not anticipate it arising. To prepare for this unlikely eventuality, HM Treasury intends to use powers in the European Union (Withdrawal) Act (EUWA) to ensure that the UK continues to have a functioning financial services regulatory regime in all scenarios.

1.9 The EUWA repeals the European Communities Act 1972 and converts into UK domestic law the existing body of directly applicable EU law (including EU Regulations). It also preserves UK laws relating to EU membership – e.g. legislation implementing EU Directives. This body of law is referred to as "retained EU law".[3] The EUWA also gives ministers powers to prevent, remedy or mitigate any failure of EU law to operate effectively, or any other deficiency in retained EU law, through SIs. We sometimes refer to these contingency preparations for financial services legislation as 'onshoring'. These SIs are not intended to make policy changes, other than to reflect the UK's new position outside the EU, and to smooth the transition to this situation. The scope of the power is drafted to reflect this purpose and is subject to further restrictions, such as the inability to use the power to impose or increase taxation, or establish a public authority.[4] The power is also time-limited and falls away two years after exit day.[5]

1.10 HM Treasury also plans to delegate powers to the UK's financial services regulators to address deficiencies in the regulators' rulebooks arising as a result of exit, and to the EU Binding Technical Standards (BTS) that will become part of UK law. Such sub-delegated powers will be subject to broadly the same constraints as HM Treasury's use of the Act's powers, as well as additional mechanisms to ensure robust HM Treasury oversight. An SI to achieve this will be laid

[2] *Procedures for the Approval and Implementation of EU Exit Agreements: Written statement - HCWS342*, Mr David Davis (Secretary of State for Exiting the European Union), December 2017. https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-12-13/HCWS342/

[3] Paragraph 23 of the *Explanatory Notes on the European Union (Withdrawal) Act 2018 (c.16) for a* definition of "retained EU law", and Section 8 for an explanation of the deficiency fixing power. http://www.legislation.gov.uk/ukpga/2018/16/pdfs/ukpgaen_20180016_en.pdf

[4] Outlined in Clause 8(7) of the *European Union (Withdrawal) Act 2018 (c.16).* http://www.legislation.gov.uk/ukpga/2018/16/pdfs/ukpga_20180016_en.pdf

[5] Outlined in Clause 8(8) of the *European Union (Withdrawal) Act 2018 (c.16).* http://www.legislation.gov.uk/ukpga/2018/16/pdfs/ukpga_20180016_en.pdf

before Parliament now that the EUWA has received Royal Assent.[6] Further information on regulatory changes to BTS and regulators' rules for EU exit will be provided by the financial services regulators in due course.[7]

1.11 The government is continuing this work to ensure that the UK will have a functioning legislative and regulatory framework in all scenarios. As part of this, HM Treasury intends to legislate to provide the financial services regulators with powers to introduce transitional measures that they could use to phase in any onshoring changes.

1.12 This means that firms do not need to prepare now to implement onshoring changes in the event no deal is reached with the EU.

1.13 Firms should continue to plan on the assumption that an implementation period will be in place from 29 March 2019 – and, therefore, that they will be able to trade on the same terms that they do now until December 2020. They will need to comply with any new EU legislation that becomes applicable during this period.

1.14 HM Treasury, working closely with the financial services regulators, has undertaken a thorough review of EU and UK domestic financial services legislation to identify deficiencies that will arise when the UK leaves the EU and existing EU law is transferred to UK law. HM Treasury is drafting SIs to fix these deficiencies and will begin laying these under the EUWA.

1.15 Wherever practicable, our approach is that the same laws and rules that are currently in place in the UK would continue to apply at the point of exit, providing continuity and certainty as we leave the EU. However, some changes would be required to reflect the UK's new position outside the EU. These changes would not take effect in 29 March 2019 if, as expected, we enter an implementation period.

1.16 Examples of deficiencies in financial services legislation include:

- Functions that are currently carried out by EU authorities would no longer apply to the UK (for example, supervision of trade repositories, which HM Treasury proposes to transfer to the Financial Conduct Authority);
- Provisions in retained EU law that would become redundant (for example, references to European Consumer Credit Information and Member States);
- Provisions that would be inconsistent with ensuring a functioning regulatory framework – for example, requirements regarding automatic recognition of an action by an EU body by the relevant UK body – where alternative arrangements for cooperating with EU bodies would be more appropriate;

[6] *Draft Statutory Instruments: 2018 No. Exiting the European Union, Financial Services, Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018.*
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/701834/draft_Financial_Regulators__Powers__Technical_Standards__Regulations.pdf

And see *Covering note on the Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018.*
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/700713/Covering_note_for_draft_Financial_Technical_Standards_SI.pdf

[7] *FCA Role Preparing for Brexit*, Financial Conduct Authority, June 2018. https://www.fca.org.uk/news/statements/fca-role-preparing-for-brexit

Bank of England's approach to financial services under the EU Withdrawal Act, June 2018. https://www.bankofengland.co.uk/news/2018/june/boes-approach-to-financial-services-legislation-under-the-eu-withdrawal-act

- Provisions that would lead to significant disruption for firms or customers of firms, unless action is taken to avoid that disruption (for example, to prevent the market disruption that would result from the sudden inoperability of passporting rights);
- Provisions requiring participation in EU institutions, bodies, offices and agencies (for example, joint decision making in supervisory and resolution colleges) which would no longer work after exit.

HM Treasury's approach to fixing deficiencies

1.17 In the unlikely scenario that the UK leaves the EU without a deal, the UK would be outside the EU's framework for financial services. The UK's position in relation to the EU would be determined by the default Member State and EU rules that apply to third countries at the relevant time. The European Commission has confirmed that this would be the case.[8]

1.18 In light of this, our approach in this scenario cannot and does not rely on any new, specific arrangements being in place between the UK and the EU. As a general principle, the UK would also need to default to treating EU Member States largely as it does other third countries, although there are instances where we would need to diverge from this approach, including to provide for a smooth transition to the new circumstances. The principles that would lead to deviations from this approach are set out below.

1.19 In some areas, correcting deficiencies to reflect this environment would be relatively straightforward. The UK's world-leading financial sector is overseen by HM Treasury and underpinned by a strong legislative framework with world-class regulators (the Bank of England/Prudential Regulation Authority and Financial Conduct Authority). This means that the responsibilities of EU bodies could be re-assigned efficiently and effectively, providing firms, funds and their customers with confidence after exit.

1.20 In this scenario, EU financial services firms operating in the UK would broadly become subject to the same supervisory regime that the UK already applies to other third countries – a regime that is shaped by the highly global, cross-border nature of financial services and the UK's robust regulatory framework as set out in legislation, including in the Financial Services and Markets Act 2000 (FSMA), the Banking Act 2009 and the Bank of England Act 1998. This existing UK financial services legislative framework provides powers for extensive cooperation with global regulatory bodies. When the UK is no longer an EU Member State, and so the EU obligation of reciprocal cooperation no longer applies, this existing framework could be relied upon to ensure this important cooperation continues in this scenario.

1.21 HM Treasury recognises that in some areas, given the complex and highly integrated nature of the EU financial services system, deficiencies would not be adequately resolved by defaulting to existing third country frameworks alone. In such cases, a different approach might be needed to manage the transition to a stand-alone UK regime. HM Treasury has identified several principles that would justify taking a different approach:

- Having a functioning legislative and regulatory regime in place, in particular the regulators' capability to fulfil their statutory objectives as set out in FSMA;

[8] *Withdrawal of the United Kingdom and EU rules in the field of banking and finance,* Directorate-General for Financial Stability, Financial Services and Capital Markets Union (European Commission), February 2018. https://ec.europa.eu/info/publications/180208-notices-stakeholders-withdrawal-uk-banking-and-finance_en

- Enabling regulators and firms to be ready – by minimising disruption and avoiding material unintended consequences for the continuity of service provision to UK customers, investors and the market;
- Protecting the existing rights of UK consumers;
- Ensuring financial stability.

1.22 For example, recognising the need to provide for continuity and to allow time to prepare for a smooth transition to the new regime, it would be appropriate for HM Treasury to introduce a Temporary Permissions Regime (TPR), in line with the announcement made in December 2017. To deal with the loss of their passporting rights on the UK's exit from the EU without a negotiated agreement, the TPR would allow EEA firms to continue operating in the UK for a time-limited period after the UK has left the EU. For those firms wishing to maintain their UK business on a permanent basis, the regime would provide sufficient time to apply for full authorisation from UK regulators. [9]

1.23 In addition to the TPR, HM Treasury intends to introduce further specific transitional regimes for entities operating cross-border and outside of the passporting framework. This is part of onshoring planning to maximise certainty and continuity for firms and consumers. HM Treasury is aware that firms would need time to adjust to this changed regulatory regime in the unlikely event it is needed, and therefore intends to provide the financial services regulators with a general power to phase in post-exit requirements, allowing flexibility for firms to transition to a fully domestic UK regulatory framework.

Split of responsibilities between HM Treasury and the financial services regulators

1.24 In leaving the EU without a deal, many functions currently carried out at an EU level would cease to apply to the UK and would need to be provided for in the UK's regulatory regime. HM Treasury's onshoring work involves allocating these EU functions to the appropriate UK bodies. In this scenario, HM Treasury proposes to follow the model outlined in FSMA and allocate functions to UK regulators in a way which is consistent with the responsibilities already conferred on them by Parliament, thus providing certainty and continuity for firms.

1.25 Further information about how HM Treasury proposes to allocate responsibilities between HM Treasury and the financial services regulators in this scenario can be found in the draft Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018 and accompanying explanatory note, published in April 2018.[10]

1.26 Additionally, HM Treasury has confirmed that in this scenario it intends to transfer supervisory powers to the FCA to regulate credit ratings agencies and trade repositories currently supervised at the European level by the European Securities and Markets Authority (ESMA), and

[9] *Financial Services Update: Written statement - HCWS382,* Mr Philip Hammond (The Chancellor of the Exchequer), December 2017. https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-12-20/HCWS382/

[10] *Draft Statutory Instruments: 2018 No. Exiting the European Union, Financial Services, Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018.*
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/701834/draft_Financial_Regulators__Powers__Technical_Standards__Regulations.pdf

And see *Covering note on the Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018.*
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/700713/Covering_note_for_draft_Financial_Technical_Standards_SI.pdf

it intends to give functions and powers in relation to non-UK central counterparties and non-UK central securities depositories, also currently exercised by ESMA, to the Bank of England. [11]

1.27 When the regulators use the delegated EUWA powers to correct deficiencies in BTS and their own rules, HM Treasury will be required to approve the instruments which give effect to those fixes. HM Treasury will ensure that those fixes are consistent with the powers set out in the Act and are also consistent with changes that Parliament has approved in onshored legislation.

1.28 After exit, HM Treasury proposes that the regulators take on responsibility for maintaining BTS. Under this proposal, when one of the regulators proposes a change to BTS, HM Treasury will be required to approve the instrument that gives effect to the change. HM Treasury may not approve a proposed change to BTS if it appeared to the Treasury that the proposal would have implications for public funds or would prejudice negotiations for an international agreement.

1.29 In addition to the role that HM Treasury will play in approving instruments which correct deficiencies in BTS and FSMA rules, or instruments which make changes to BTS after exit, the regulators will be required to provide an annual report to Parliament setting out how they have exercised any powers delegated to them under the EUWA. This requirement for a report on EU Withdrawal Act delegated powers is set out in Schedule 7, Part 3 of the Act.

Next steps

1.30 HM Treasury recognises the importance of keeping stakeholders engaged on this work and ensuring that there is an opportunity to contribute. Therefore, HM Treasury, along with the financial services regulators, will engage stakeholders to discuss financial services onshoring work.

1.31 HM Treasury intends to lay the first financial services onshoring SIs soon. Among the first SIs laid will be the SIs delivering the Temporary Permissions Regime, the Temporary Recognition Regime for central counterparties and the SI sub-delegating the power to fix deficiencies in BTS and regulator rulebooks to the financial services regulators.

1.32 Further SIs fixing deficiencies in EU legislation will be laid over the Autumn into early 2019. HM Treasury plans to lay these SIs in groups, with some of the first to be laid in Autumn covering significant files relating to prudential regulation and capital markets. HM Treasury plans to publish drafts of these SIs and accompanying explanatory information over the summer, ahead of laying, to give stakeholders an opportunity to engage and familiarise themselves with the draft provisions.

1.33 The financial services regulators will set out their own plans for stakeholder engagement on amendments to their rulebooks and BTS in due course.

1.34 The immediate aim of this onshoring work is to prepare for the unlikely scenario in which the UK leaves the EU with no agreement and no implementation period. However, we expect much of this onshoring work, augmented by the outcome of further negotiations with the EU, will contribute towards the legislative framework needed to deliver a smooth and orderly transition to the new regime that will be agreed as part of the Future Economic Partnership. Further information on this will be made available in due course.

[11] *Financial Services Update: Written statement - HCWS382,* Mr Philip Hammond (The Chancellor of the Exchequer), December 2017. https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-12-20/HCWS382/